

# EXHIBIT B

1 UNITED STATES BANKRUPTCY COURT

2 SOUTHERN DISTRICT OF NEW YORK

3 Adv. Case No. 10-04377-smb

4 Adv. Case No. 10-04658-smb

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6 IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF BERNARD L.

7 MADOFF INVESTMENT SECURITIES LLC,

8 Plaintiff,

9 v.

10 NELSON et al.,

11 Defendants.

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13

14 United States Bankruptcy Court

15 One Bowling Green

16 New York, NY 10004

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18 May 8, 2019

19 10:22 AM

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21 B E F O R E :

22 HON STUART M. BERNSTEIN

23 U.S. BANKRUPTCY JUDGE

24

25 ECRO: NAROTAM RAI

1 HEARING re 10-04377-smb TRIAL

2

3 HEARING re 10-04377-smb Motion In Limine Number 1 to Admit

4 the Plea Allocutions of Bernard L. Madoff and BLMIS

5 Employees (also applies to Adv. Proc. No. 10-04658)

6

7 HEARING re 10-04377-smb Motion In Limine Number 2 to Admit

8 the Trial Testimony of Frack DiPascali (also applies to Adv.

9 Proc. No. 10-04658)

10

11 HEARING re 10-04377-smb Motion In Limine Number 3 to Exclude

12 Testimony and Exhibits Related to Defendants Asserted Tax

13 Obligations to Governmental Taxing Authorities (also applies

14 to Adv. Proc. No. 10-04658)

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16 HEARING re 10-04658 TRIAL

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25 Transcribed by: Sonya Ledanski Hyde

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12 ROBERT A. RICH

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1 deposition, and the new disclosure, Ms. Agatha Cole as a  
2 witness.

3 As to Mr. Madoff and Ms. Pitt, I think it -- the  
4 issue here is not the relevance, which is the argument that  
5 Defendants made in their papers. They're relevant. They  
6 worked at BLMIS. They perpetrated fraud. That's not the  
7 issue here.

8 The issue here is that Your Honor has ruled on.  
9 We've had years of discovery, years of discovery dispute,  
10 and Your Honor has already ruled that any deposition,  
11 particularly the Madoff deposition that was taken after the  
12 close of discovery in this case, would not -- are not --  
13 that they are not permitted to participate in Madoff's  
14 deposition, and that deposition would not apply in that  
15 case.

16 THE COURT: I understand that, but, you know, they  
17 weren't permitted to participate in the Bonaventure trial  
18 either, and I don't see the difference between your argument  
19 for using DiPascali's testimony and the argument to use  
20 Madoff's and -- I'm sorry, I forget the other witnesses'  
21 names -- deposition testimony. Isn't it really the same  
22 issue?

23 MS. HOANG: It's actually not, Your Honor. Your  
24 Honor has already ruled in this case as to Mr. Madoff and  
25 Ms. Pitt. As to the -- as to DiPascali, there's other

1 there's a Ponzi scheme. In other words --

2 MS. CHAITMAN: Some are the same facts. They --  
3 some are not. And clearly, the defense counsel had no  
4 interest in cross-examining to elicit what I would try to  
5 elicit if I were cross-examining those witnesses.

6 The other thing is, Judge, this is a complete  
7 surprise to us because, as we've pointed out in our papers,  
8 in the Trustee's initial disclosures, they not only didn't  
9 list any of these witnesses, they expressly stated they do  
10 not intend to rely on any former BLMIS employees. And they  
11 never corrected that. They didn't do it during the period  
12 of discovery. They didn't do it until they served their --

13 THE COURT: Did you identify Madoff and this other  
14 witness --

15 MS. CHAITMAN: Yes.

16 THE COURT: -- that you want to use now in your  
17 initial disclosures?

18 MS. CHAITMAN: We named a couple of Madoff  
19 employees, and we said --

20 THE COURT: But you didn't name Madoff.

21 MS. CHAITMAN: And we -- I'm sorry?

22 THE COURT: Did you name Madoff?

23 MS. CHAITMAN: I -- you know what? I can't  
24 remember. I'd have to look.

25 MS. HOANG: No, Your Honor.

1 but that's a hypothetical situation.

2 MS. CHAITMAN: Well, I think -- I think what I  
3 would suggest then is that we deal with this in post-trial  
4 briefing.

5 THE COURT: I agree with you.

6 MS. CHAITMAN: Okay.

7 THE COURT: I agree with you. There's no --

8 MS. CHAITMAN: Because I'm not --

9 THE COURT: I mean, I can read the -- I can read  
10 it and you can read it at some other time. I'd like to  
11 being the trial.

12 MS. CHAITMAN: Okay.

13 THE COURT: Are there any other motions that I  
14 have to deal with?

15 MS. HOANG: No, Your Honor.

16 MS. CHAITMAN: Well, they're also seeking to admit  
17 the testimony of (indiscernible) Pitts at the criminal  
18 trial, and --

19 MS. HOANG: No. We're not.

20 THE COURT: I -- that's not my understanding.

21 MS. CHAITMAN: No?

22 MS. HOANG: No.

23 MS. CHAITMAN: So the only --

24 MS. HOANG: No, you wrote that in your papers.

25 MS. CHAITMAN: Okay. That's my misunderstanding.



1 Q Were you able to determine when BLMIS changed from the  
2 convertible arbitrage strategy to the split strike strategy?

3 A Right around the early '90s. This was the time period  
4 after the SEC had been in to investigate the accounting firm  
5 of Avellino and Bienes, who had been putting money into  
6 BLMIS through taking money from their clients and posing  
7 them as investor notes. And when that seemed to all  
8 unravel, now, Mr. Madoff was faced with about 4,500 clients  
9 -- instead of having one accounting firm to deal with and  
10 one set of clients in that, now he had thousands of clients  
11 to deal with because they had been potentially or  
12 purportedly making a decent return and they wanted to come  
13 back for more. And the convertible arbitrage at that point,  
14 it was very difficult and time consuming to try to -- to try  
15 to perpetrate the fraud. It took a lot of work, as you'll  
16 see when I go through. And so, the split strike conversion  
17 strategy was born or was utilized.

18 This was not a strategy created by Mr. Madoff.  
19 The split strike conversion strategy is a legitimate trading  
20 strategy that people use on Wall Street. So, this was  
21 nothing genius that Mr. Madoff put in to play, but this was  
22 something he put in to play to allow it to be scalable so  
23 you could deal with thousands of people in that regard.

24 Q Okay. So, during the time we're talking about here,  
25 you mentioned there were two legs of the BLMIS business.

1 How was it structured?

2 A So, BLMIS, Your Honor, was structured -- kind of two  
3 sides of the business. One I'll refer to as the investment  
4 advisory side. Sometimes I might slip and call it House 17  
5 because it was located on the 17th floor of the Lipstick  
6 Building here in Manhattan. The other side was the  
7 proprietary trading and market-making business. And I'll  
8 just refer to that throughout the trial as the prop trading  
9 side of the business. But proprietary trading is basically  
10 when a broker-dealer uses its own money to trade for its own  
11 account to make profits for itself. So, somebody like  
12 Goldman will have a prop trading desk and they'll try to  
13 make money with their own money.

14 The market-making side is acting as a market maker  
15 in certain stocks and creating flow into the market, and  
16 acting as a broker-dealer to take orders for buys and sells.  
17 So, that was going on in the prop trading side of the  
18 business. And sometimes I might slip and refer to that as  
19 House 5. That's how that was known in a lot of the records.  
20 So, basically, the investment advisory side and the prop  
21 trading side -- two sides of BLMIS.

22 Q So, was the prop trading side of the business designed  
23 to buy and sell securities?

24 A Absolutely.

25 Q All right. What about the investment advisory side of

1 the business? What was it? What was it designed to do?

2 A Well, it was designed to purportedly trade stocks to  
3 buy equities, to buy options. Under the split strike  
4 conversion strategy, it would be using puts and calls. And  
5 I'll explain that in more detail. And it was also  
6 purportedly to -- when Mr. Madoff thought the timing was  
7 right, to unwind these trades and put the money supposedly  
8 in treasuries. That's what it was purported to do. The  
9 problem is it never did that.

10 Q So, I was going to ask you that. So, the proprietary  
11 trading side of the business bought and sold securities?

12 A Absolutely.

13 Q The investment advisory side?

14 A Never.

15 Q Okay. To operate a securities tradings business like  
16 BLMIS, do you need money?

17 A You do need money, yes.

18 Q Do you need computers?

19 A You need a vast computer system. If you're going to be  
20 a broker-dealer like BLMIS and do prop trading, you need  
21 sophisticated computer systems.

22 Q Let's talk about computers first.

23 A Okay.

24 Q You mentioned the AS400.

25 A Yes.

1 execute anything because there were no connections to it.

2 And then it could print out statements. So, some of the

3 same programs that were present over in the prop trading

4 side originally on the AS400 were taken, used in the IA

5 business to facilitate doing some of the same tasks, but it

6 lacked any capability to actually trade.

7 Q So, the proprietary trading side of the business had a  
8 trading platform?

9 A It had a trading platform and it actually traded.  
10 That's what it did.

11 Q Was it set up to buy and sell stocks?

12 A Absolutely.

13 Q How about options?

14 A Absolutely.

15 Q How about treasuries?

16 A Absolutely.

17 Q How about the computer at the investment advisory  
18 business, the AS400, was that a trading platform?

19 A Absolutely not, Your Honor.

20 Q Was it set up to buy and sell stocks?

21 A It was not.

22 Q Was it set up to buy and sell options?

23 A It was not.

24 Q How about treasuries?

25 A It was not.

1           And so that system was present and working in the  
2       prop trading business. There was software from it, there  
3       were documents from it, there was architecture documents,  
4       how that was hooked up, and that was in the prop trading  
5       business.

6           On the IA side of the business, Your Honor, it  
7       didn't exist. There's no need -- if you're not trading any  
8       stocks and you're not doing anything, you don't need all  
9       these systems. Systems have servers, servers take up room,  
10      people can have access to it, they can see what you're  
11      doing. So, in the midst of perpetrating a fraud, things you  
12      don't need you don't put in the room. You leave it out.  
13      And that's why these things were not present over in the IA  
14      business.

15      Q     Staying on Page 3, just scroll down a little bit, I'd  
16      like to talk to you about NASDAQ QIX. The NASDAQ QIX,  
17      whatever that is. Can you tell us what that was? What a  
18      day.

19      A     So, from the NASDAQ market, it's the -- it was a system  
20      that gave you access to real time market data, and it's a  
21      trading system. So, you could actually place trades through  
22      that. And, interestingly enough, Mr. Madoff was involved in  
23      NASDAQ. You see it on the prop trading side of the business  
24      because there were stocks being executed, and buys and  
25      sells, and prop trading, and market-making activities.

1 Again, there's no checkmark under the IA business  
2 because there's no need for it. You don't need real time  
3 market quotes and trading when you're not doing trading.

4 Q I missed one on Page 2. If you could just flip back to  
5 Page 2 of Exhibit 44? What was the Fix Engine?

6 A Oh. The Fix Engine, it's kind of like an instant  
7 message communication system for trade-related messages  
8 between market participants. So, there's information on --  
9 going back and forth on trading, on what the pricing is.  
10 It's an important component if you're actively in the  
11 market, and you may have -- before you place an order, you  
12 may have a large order of a million shares of Exxon, which  
13 would be a larger order. You don't want to just put that  
14 onto the market. It can tilt the market pretty quickly.

15 So, you may, through Fix, talk to another market  
16 participant. Did they have a buyer for a piece -- you know,  
17 maybe 250,000 shares? So, it's used between the market  
18 participants to help form the market and efficiently create  
19 the process for trading. Again, you'll see that for the  
20 prop trading business. It makes sense. They're trading  
21 stocks and other instruments. You don't see it for the IA  
22 business. Again, you don't need it because nothing as going  
23 on.

24 Q Now, let's go back to Page 3. Sorry about that detour.  
25 And if you can take a look at the Order Audit Trail System

1 row of Exhibit 44.

2 A Right.

3 Q Tell Judge Bernstein what that's about.

4 A So, Your Honor, a very important system -- even by its  
5 name, the Order Audit Trail System denotes that anything  
6 with the word audit in it is usually important. In the  
7 trading world there are things called broken trades. A  
8 trade goes through, is placed and it's never filled.  
9 There's some kind of break in the trade that needs to be  
10 reconciled every night. There needs to be an audit trail of  
11 trades for regulators to come in, be it federal regulators  
12 or state regulators.

13 So, this provided -- it tracked the orders,  
14 including the origination, transmission, and cancellation or  
15 execution. Basically, the history of what's going on with  
16 an order. That was functioning in the prop trading  
17 business. It was not present in the IA business. Again,  
18 nothing was being done in the IA business with real stocks,  
19 or bonds, or trading, so you don't need an audit trail when  
20 you're making everything up.

21 Q What about on Page 4, Stratus Boss? Can you tell us  
22 about that and why it was one place and not the other?

23 A So, the Stratus system is a frontend processing system  
24 which maximizes the trading speed. We've heard a lot  
25 certainly coming out of the financial crisis of high-

1 it never indicated that there was a correction. It was just  
2 the ability to go make things disappear and reappear. Kind  
3 of the magic behind the curtain, so to speak.

4 Q I think you've answered this question but based on your  
5 review of the computer systems ab BLMIS, were you able to  
6 determine if any trades were being processed through the  
7 investment advisory business computers?

8 A I was able to make that determination and the answer is  
9 they were not. There was no evidence, Your Honor, of any  
10 trades being executed through the IA business computer  
11 systems whatsoever.

12 Q So, in your professional opinion, can a securities  
13 trading business like BLMIS investment advisory business  
14 operate without a connected trading platform?

15 A No, it can't.

16 Q So, we've talked about computers. Now let's talk about  
17 money. Before you can buy or sell stocks, options,  
18 treasuries, do you need a source of funds?

19 A You do.

20 Q I want to discuss the source of funds at the BLMIS  
21 investment advisory business, okay?

22 A Okay.

23 Q Does your report include a demonstrative aid to help us  
24 explain those sources of funds? I think it's Trial Exhibit  
25 37. And I think we have that on the board, too, don't we?



1 THE COURT: Is that in the report?

2 MR. HUNT: It's in the report as well, Your Honor.  
3 I think it's Page 121, Figure 39.

4 THE COURT: Okay, thank you.

5 MR. HUNT: It kind of looks like a house. I don't  
6 know if we can get that up there.

7 Q Can you identify Exhibit 37 for the record?

8 A Exhibit 37 is my Figure 39 from Page 121 of my expert  
9 report. And it is a graphic that I prepared. Basically, in  
10 conducting the investigation, I wanted to see where the  
11 money was coming from, kind of like follow the money, and to  
12 really hone in on how the money went into the IA business  
13 and how it came out. And just to give a closure to any sort  
14 of thought that somehow the AI business was doing business  
15 through somebody else.

16 Q So, we'll probably be referring back to Exhibit 37 from  
17 time to time. Did you review the books and records related  
18 to each of the bank accounts held by BLMIS?

19 A I did.

20 Q Did you determine what bank account the BLMIS  
21 investment advisory business deposited customer  
22 (indiscernible)?

23 A It's what I've referred to as the J.P. Morgan Chase  
24 703 account. The 703 were the last three digits of the  
25 account number. That was the main account where customer

1 money was deposited in for the IA business.

2 Q What's a sweep account?

3 A A sweep account, Your Honor, is if you have a business  
4 checking account and you're maintaining a bunch of money in  
5 that checking account, banks typically don't pay very much  
6 interest on checking accounts. Historically, very low. And  
7 so to maximize your cash efficiency, you can arrange -- if  
8 the bank is large enough; usually this is with the larger  
9 banks -- a situation where every night above a certain  
10 amount, they may leave you with \$10,000 in the bank account.  
11 They will sweep out the rest of the money and put it into  
12 very short-term overnight investments.

13 It could be a bankers acceptance type note, it  
14 could be just a short-term treasury bill in and out. But,  
15 basically, it is a way to maximize idle money sitting in an  
16 account. Instead of just letting it sit in a checking  
17 account, it's able to earn a little bit more that way. And  
18 it goes out the night, it comes back the next morning. So,  
19 that's why they call it an overnight sweep, if you're using  
20 a sweep account as an overnight sweep.

21 Q Were there any overnight sweeps associated with the 703  
22 account?

23 A There were, yes.

24 Q If you could, Mr. Dubinsky, turn to Exhibit 38 in your  
25 binder, which is also Figure 37 on Page 117 in your report.

1 Do you have that, sir?

2 A I do have that, yes.

3 Q If you could describe what Exhibit 38 depicts?

4 A So, Your Honor, I wanted to see, in order to determine  
5 whether there was actual trading going on in the investment  
6 advisory business, I wanted to see what cash accretions were  
7 going into the 703 account. Where was the cash coming from?  
8 And this shows that 97 percent of all the cash going into  
9 the 703 account came from customers. Customers -- either  
10 new customers putting money in or existing customers putting  
11 additional money in.

12 There's a small slice for 3 percent, what I've  
13 called Other Additions, and that is money that came back in  
14 vis-à-vis money that was earned on the overnight sweeps over  
15 the period when this was computed. So, basically, what I --  
16 what this shows me is if there were trading going on in the  
17 investment advisory business, and as purportedly was shown  
18 on customer statements, those trades were consistently  
19 earning money -- they were never losing, they were always  
20 making money -- you would see another huge slice of this  
21 pie, probably 80 percent of it being from trading profits.  
22 Because money has to come back in to the account at some  
23 point if you're going to turn it back into cash, as clients  
24 want to get out, from the trading profits when they sold  
25 their investments.

1           There was never any addition to the 703 account  
2           that I saw when I examined the bank accounts to show that  
3           money was coming from trading profits. Again, if somebody  
4           wanted to close their account or take money out -- as many  
5           people took out millions and millions of dollars over the  
6           years -- it had to come out of the 703 account. That was  
7           the investment advisory account. There was another account  
8           that money from 703 went to to wire the money out or write  
9           the checks, but that was just a disbursement account. This  
10          was the main account.

11                 And that's a very important finding because  
12           without additional money coming in from trading gains, that  
13           believes the notion that there were, in fact, trading gains.  
14           There weren't.

15          Q       We'll talk about those in a little bit more detail.  
16           So, what sources of information did you use to prepare this  
17           Exhibit 38?

18          A       These were bank statements from -- that were obtained  
19           from J.P. Morgan Chase. And in addition to the bank  
20           statements, there were -- there was information on customer  
21           money in the computer file and that was utilized as well to  
22           look at -- to match up the cash additions coming to the  
23           account to try to bundle where that money was coming from.  
24           In other words, to make sure that if a deposit came in, say,  
25           \$3 million, it wasn't traceable back to the profits from

1 some alleged stock trade. It was all traced back to client  
2 money, customer money.

3 Q Okay, so let me see if I understand this. You're  
4 saying that 97 percent of the money going into the  
5 investment side, investment advisory side of BLMIS was  
6 coming directly from customers. Is that what you're saying?

7 A That's correct.

8 Q Okay. There's 3 percent that comes from investment  
9 activity, overnight sweeps, and stuff like that, right?

10 A Correct.

11 Q Where did the money come from to make those  
12 investments, those short-term investments?

13 A Customer money. It was taken out of the 703 account  
14 and then invested overnight and then put back in the 703.  
15 So, it originated from customer money just as a way to earn  
16 a little bit more interest than the money sitting in the 703  
17 checking account.

18 Q So, what was the source of all of the money deposited  
19 into the 703 account?

20 A Both the 97 percent and the 3 percent were from  
21 customer money. Because if you -- the 3 percent is the  
22 derivative, if you will, of the earnings of those overnight  
23 sweeps, it would come from customer money.

24 Q Okay. So, looking at Exhibit 37, I guess we've  
25 identified where the money came from that went into the blue

1 up there.

2 A Yeah, so --

3 THE COURT: Which page? I'm sorry, which page is  
4 that in the report? Oh, I have it. Page 121.

5 MR. HUNT: Okay. Sorry.

6 A So, yes. Under -- there's a box underneath the blue  
7 box that says IA Business, or there's a line with an arrow  
8 that says Dividends. And I have an X there. That was one  
9 of the things that I eliminated by doing this analysis.  
10 That the dividends were never received.

11 I also should say I looked for documentation from  
12 the transfer agents saying, well, here's a transmittal, it's  
13 going to be wired to the account. Here's, you know, \$20  
14 million for a particular dividend payment. I looked for why  
15 are remittances...? I mean, I scoured the documents to see  
16 -- maybe the money came in somewhere and somehow evaporated  
17 somewhere else. I don't know. But I looked for all of the  
18 information that would be surrounding the transmittal, and  
19 there was none of it.

20 Q In fact, in your review of the BLMIS books and records,  
21 did you identify any other income-producing activities for  
22 the investment advisory business, other than the short-term  
23 sweeps and the BLMIS interest-bearing accounts that were  
24 funded by 703 customer deposits, what you just discussed?

25 A No. There were several brokerage accounts, that money

1 was taken from the 703 account and put into, that purchased  
2 some treasuries. But other than -- and those weren't  
3 purchased in connection with any split strike conversion  
4 strategy. But, no, other than that, there was absolutely no  
5 evidence of any trading whatsoever going on in the IA  
6 business.

7 Q How about any third party financing the investment  
8 advisory arm was receiving? Did you find any of that?

9 A Other than about \$145 million worth of loans, I think  
10 it was either 2005 or '06, Your Honor, there was somewhat of  
11 a liquidity crush. You know, again, when you're running a  
12 Ponzi scheme like this, the big fear is kind of the run on  
13 the bank. If everybody shows up to cash out, you don't have  
14 the money to pay everybody and that's when these things  
15 collapse.

16 And so there was a liquidity crunch in the mid-  
17 2000s, and there was as loan -- two loans obtained from a  
18 bank that were very short term. I think within six months,  
19 the loans were paid off. I think it was about \$145 million.  
20 It's in the report. Other than that -- and that would be --  
21 that was not enough to sustain -- that was a short-term kind  
22 of bridge loan.

23 But back to your original question, that was the  
24 only third party financing I saw. There was no other  
25 legitimate business within the IA business, and no sort of

1 use of the money in a legitimate way to create any sort of  
2 other profits for the IA business.

3 Q Where would all that money have shown up?

4 A In the 703 account. That was the account that was used  
5 for the IA business.

6 Q Is that why you have the big red Xes on all of those  
7 possible incoming sources of funds?

8 A It is. I was trying again to see where the money was  
9 coming in, how it was being earned, was there -- you know,  
10 maybe Mr. Madoff said he was going to trade stocks but he,  
11 you know, just invested in gold bars somewhere. And while  
12 that would've have been right, maybe there was an investment  
13 somewhere else, and then he was selling those gold bars and  
14 producing some income. So, that's the other income  
15 producing box in the upper right.

16 There was no evidence other than money coming in  
17 from customers and money going out to customers. A little  
18 bit of the sweep, the overnight sweeps to kind of create  
19 more money for the Ponzi to enable it to go a little bit  
20 longer, in other words. And that's why I have Xes on all of  
21 those.

22 Q So, based on your review of the books and records of  
23 BLMIS, did you reach a conclusion about the source of funds  
24 for the 703 account?

25 A I did.



1 Q I probably asked and answered that one but I'll ask it  
2 again.

3 A It came from the IA business customers.

4 Q Was J.P. Morgan Chase formerly known as Chase  
5 Manhattan Bank? Do you remember that?

6 A It was.

7 Q Did Mr. Madoff testify in his allocution about how he  
8 used that bank account?

9 A I recall he did, yes.

10 Q If you could turn to the Trustee's Exhibit 1 in your  
11 binder. It's the small binder, I think. You're going to be  
12 happy about that.

13 THE COURT: Do you have that allocution?

14 MR. HUNT: Yes, sir, it's --

15 THE COURT: You had had it separate from --

16 MR. HUNT: Oh, yeah, we do. We have it in a small  
17 bound copy.

18 THE COURT: Well, give it to me, rather than...

19 (indiscernible)

20 MR. HUNT: Do you have...?

21 MR. DUBINSKY: I have a small binder that says  
22 Regarding Madoff Allocution.

23 THE COURT: Right. I have a copy of it from...

24 MR. HUNT: Sorry, I apologize. I thought I'd  
25 provided it.

1 THE COURT: I think I turned it away because I  
2 said I didn't need it.

3 MR. HUNT: It's Trustee's Exhibit 1.

4 THE COURT: I have it.

5 MR. HUNT: Okay, thank you.

6 Q If you could please read Mr. Madoff's allocution  
7 starting at the end of Line 15 on Page 24. On Page 24.

8 A So, Page 24 starting at the end --

9 Q At the end of Line 15 through the end of the first  
10 sentence on Line 22.

11 A Okay. "Up until I was arrested on December 11, 2008, I  
12 never invested these funds in the securities as I had  
13 promised. Instead, those funds were deposited in a bank  
14 account at Chase Manhattan Bank. When clients wished to  
15 receive the profits they believed they had earned with me or  
16 to redeem their principal, I used money in the Chase  
17 Manhattan Bank account that belonged to them or other  
18 clients to pay the requested funds."

19 Q Did your investigation confirm if Mr. Madoff's  
20 allocution accurately reflected how the Chase accounts were  
21 used to pay redemptions?

22 A It did. And it does accurately reflect what my  
23 investigation concluded, that that's how it was used.

24 Q Just going back to the dividends we talked about to  
25 clean up the point. Were there any records showing that any

1 of these \$4 billion of cash dividends were deposited into  
2 any other bank account?

3 A No. I scoured every other bank account record and  
4 every other document. I wanted to make sure that I was  
5 certain.

6 Q So, to wrap up this issue, please summarize your  
7 conclusions concerning the source of funds flowing out of  
8 the investment advisory business to customers. Where was  
9 that money coming from?

10 A Customer money. Just other customers' money.

11 Q Did your conclusion that the BLMIS investment advisory  
12 business did not have a connected trading platform have  
13 anything to do with your conclusion that the investment  
14 advisory business was being operated as a Ponzi scheme?

15 A Absolutely.

16 Q Why?

17 A Because without the ability to actually connect to the  
18 market and trade and no evidence of those trades ever  
19 occurring, coupled with what I just testified about, that  
20 the only money I saw was customer money in and customer  
21 money out, no accretion to that 703 account from any sort of  
22 trading profit dividends -- that's the classic example of a  
23 Ponzi. There's nothing going on. You're taking money from  
24 people, you're promising that you're going to do something  
25 with it, and then you pay them back as if you're fulfilling

1       theoretically if you're doing trading?

2       A       Well that's not only theoretical, that's what actually  
3 happens in the market. If you, when you pull the data from  
4 Bloomberg, for instance, it will come out at about 50-50.

5       Q       So, if you look at the high in the lower right hand  
6 corner, talking about the proprietary trading business, what  
7 did you find?

8       A       So, this one looks at the buys. So, this was from  
9 January 2000 through November 2008. And the prop trading  
10 business was at about 51-49, almost 50-50, where you would  
11 expect to see prop traders doing the sort of buying to end  
12 up, so looking at the actual data from the prop trading  
13 business and running the formula that we just talked about.  
14 This is what, for that time period, it ended up being.

15       Q       And was the proprietary trading business actually  
16 buying stock during that period?

17       A       Yes. The proprietary trading business was buying stock  
18 for the proprietary trading desk and for the market-making  
19 clients of that side of the business. This has nothing--  
20 what we're talking about now has nothing to with the IA  
21 customers or IA business, at this point.

22       Q       If you look at the large pie on the left, talking about  
23 the IA business buys, what does that show?

24       A       So, this shows that in the IA business, what was  
25 recorded as the buys, was that the IA business was buying

1 BLMIS was trading options for its investment advisory  
2 clients?

3 A I reached the conclusion that no options were ever  
4 traded on behalf of the IA business customers.

5 Q So, let's talk about the third element of the split  
6 strike strategy, which I think you said was treasuries.

7 A Correct.

8 Q I think you did an analysis of that and it's on page 70  
9 of the report. Based on your review of the books and  
10 records, did you determine how treasuries factored into this  
11 split strike strategy the BLMIS was marketing to is  
12 customers?

13 A I did. They were supposed to be used, Your Honor, when  
14 either Mr. Madoff or somebody at BMLIS determined it was  
15 time to, quote, get out of the market, and the purported  
16 equity and option trades were unwound and then money was  
17 used to purchase treasuries, in other words, to go into kind  
18 of a parking situation during that time period. That's how  
19 it was supposed to work.

20 Q If you could turn to Exhibit One, which is Mr. Madoff's  
21 allocution, and starting in the middle of line 7, on page  
22 26, through line 11, and read that into the record please.

23 A What was the line number to start on?

24 Q It's line 7 through 11 on page 26.

25 A "I promised that I would opportunistically time those

1 purchases and would be out of the market intermittently  
2 investing client funds during these periods in United States  
3 government-issued securities such as United States Treasury  
4 bills."

5 Q And then read line 16 through 18 on that same page.

6 A "In fact, I never made those investments I promised  
7 clients who believed they were invested with me in the split  
8 strike conversion strategy."

9 Q Based on your review of the BLMIS Investment Advisory  
10 books and records, were you able to determine if Mr.  
11 Madoff's allocation concerning treasuries was accurate?

12 A It confirmed my analysis in finding that no treasuries  
13 were bought or traded for any of the investment advisory  
14 clients.

15 Q Does the DTC also get involved in documenting the  
16 purchase of treasuries?

17 A It does. It acts as the clearing house for treasuries,  
18 just like it does for equities.

19 Q Were you able to obtain DTC treasury records for BLMIS?

20 A I was. For the period of 2002 through 2007, I was able  
21 to obtain those records, and then I performed an analysis,  
22 identified the -- first I went and identified the unique  
23 treasury bills held by the prop trading business on December  
24 31 of every year. I compared those holdings to the holdings  
25 at DTC, and I also compared those holdings to the IA

1 \$80 million, that's \$56,910,000. I mean \$56 billion of  
2 missing treasuries. It's ...

3 Q How many were missing in 2006?

4 A Over 48,300,000, or 270 million.

5 Q For the period 2002 through 2007, is it your testimony  
6 that there are quite a few missing?

7 A That would be an understatement, quite a few --  
8 billions and billions and billions of dollars were missing.

9 Q So, taken in conjunction with the other evidence you  
10 identified with relating to treasuries, did you reach a  
11 conclusion regarding the purchase and sale of treasuries, by  
12 the BLMIS Investment Advisory business?

13 A There was no evidence of treasuries being purchased for  
14 the IA business customers, plain and simple.

15 Q So, switching back to Mr. DiPascali, do you recall him  
16 testifying about the nature of the split strike hedging  
17 strategy?

18 A I do.

19 Q If you could turn to Exhibit Two in your binder, Mr.  
20 DiPascali's allocutions, and read the allocution starting on  
21 page 45, line 23 through 46, line 17.

22 A "He attracted a lot of these clients by telling them  
23 that the firm would apply a hedged investment strategy to  
24 their money. The clients were told that the strategy  
25 involved purchasing what we call basket or blue chip common

1 when Duff & Phelps purchased my business, and so I  
2 liquidated some of the stock along the way.

3 Q What? I'm sorry?

4 A I had liquidated some of that stock along the way.

5 Q But if you hadn't liquidated it, it would have gone up  
6 significantly?

7 A That's correct.

8 Q Now, in the course of your work you became familiar  
9 with the Lazard report that was prepared by the Trustee in  
10 his efforts to sell the, what you refer to as the  
11 proprietary trading business.

12 A That is correct, yes.

13 Q And did you review that report?

14 A I did.

15 Q And did you find any factual inaccuracies in that  
16 report?

17 A No.

18 Q Now, you referred to the market making and proprietary  
19 trading business as one business. You call it the prop  
20 trading, right?

21 A For ease of discussion, that's what I did, yes.

22 Q Okay. The proprietary trading, in fact, was investing  
23 on Mr. Madoff's account. Isn't that true?

24 A On the account of the firm, not Mr. Madoff personally,  
25 but the account of the firm, as any prop trading desk would,



1 A That is correct, yes.

2 Q Okay. And those accounts included Lehman Brothers.

3 A Correct.

4 Q Bear Sterns.

5 A That's correct.

6 Q JP Morgan Chase.

7 A Correct.

8 Q Morgan Stanley.

9 A There was a Morgan Stanley account, yes.

10 Q Right. Now, a lot of those precise T bills were listed  
11 on the Nelson statements. You know that, don't you?

12 A I don't know that. I've never done that analysis to  
13 see if those were listed on the Nelson statements. The  
14 analysis that I have done looked in total across client  
15 statements.

16 Q Okay. You know, there are three accounts at issue  
17 here, right, for the Nelsons?

18 A Yes, that's my understanding.

19 Q Okay. Roy, can you pull up, please, Exhibit DX-EG.  
20 And can you go to page two, please? Did you look at  
21 documents like this? Did you review, for example, the  
22 Lehman account statements?

23 A I've seen these documents, yes.

24 Q Okay. And you recall that these were investments of  
25 securities that were made with investment advisory

1 customers' money, right?

2 A There was money taken out of the 703 account,  
3 transferred to these accounts, these various accounts, and  
4 then these securities were purchased, yes.

5 Q Okay. So, this shows that this is dated ... just one  
6 second ... you know what, I've confused myself on this.

7 THE COURT: It's July 2002 according to the  
8 exhibit.

9 MS. CHAITMAN: Right. Right. Hold on one second.  
10 I just have to find that document. Hold on one second. I'm  
11 sorry. You know what, I'm going to start with a different  
12 one -- I'm sorry -- because I can't find the other documents  
13 with respect to that. Would you please, Roy, pull up  
14 Exhibit DX-BJ; is that the one I just asked you for? Okay.  
15 How about -- oh, you know what, here's the problem. Can you  
16 go to Bates No. 2000 -- 20042-43 in that document?

17 MR. HUNT: Sorry. I was just going to say, while  
18 she's looking for that record where she indicated a minute  
19 ago that she is reading verbatim from the transcript about  
20 (indiscernible). I just wanted to point out that was -- her  
21 reading was not correct.

22 THE COURT: Well, the record will speak for  
23 itself.

24 MR. HUNT: I agree.

25 MS. CHAITMAN: Okay.

1 activities; isn't that true?

2 A Correct, yes.

3 Q And it was hundreds and hundreds of millions of dollars  
4 just since 2000 that was transferred from the 703 accounts  
5 to the Bank of New York account, which was used exclusively  
6 for the market making and proprietary trading activities;  
7 isn't that true?

8 A Well, it went into that bank account. I've never  
9 traced to what it was used for. It was used, presumably  
10 there were salaries being paid. Mr. Madoff's yacht was  
11 being paid out of there. There were a lot of things --  
12 office rent, houses -- a lot of things the money was used  
13 for.

14 Q And all of the securities that the traders were  
15 purchasing.

16 A It could have been. Once it's comingled, there's no  
17 way to determine what it's used for at that point.

18 Q Right.

19 A All I know, it was taken from the 703 account  
20 improperly, put over to the prop trading business.

21 Q Right. And how much money in total just from -- in the  
22 period from 2000 through 2008, how much money in total was  
23 transferred from the 703 account, which was exclusively  
24 investment advisory customers money, to the Bank of New York  
25 account, which was exclusively prop trading?

1 A I'd have to check the numbers, about \$700 or \$800  
2 million.

3 Q Right. Now, the -- what you call the prop trading  
4 business, the market making business was a huge, huge  
5 business, wasn't it?

6 A At one point, it was, yes.

7 Q Okay. And at one point, you know that Madoff conducted  
8 trades equal to approximately 10 percent of the daily volume  
9 on the New York Stock Exchange.

10 A I've seen anecdotal evidence to that, but I don't know  
11 for a fact.

12 Q Okay. You never did an analysis, say, for example, in  
13 2000 or any time between 2000 and 2008, you never did an  
14 analysis of the prop trading, the volume of prop trading as  
15 compared to other firms?

16 A No, I didn't.

17 Q Okay. But did you ever investigate who the customers  
18 of the market making unit were?

19 A I didn't investigate. There were documents with  
20 customer names, institutional clients, other banks, other  
21 customers. But beyond that, I didn't do an in-depth  
22 investigation into that side of the business for that  
23 purpose.

24 Q But it's fair to say, is it not, that the market making  
25 unit did business with all of the major financial firms in

1 what I testified to is no money was made in the investment  
2 advisory customer accounts on the purported trades that were  
3 promised to them.

4 Q So you're not -- you weren't -- you didn't seek to  
5 convince Judge Bernstein that money hadn't been made on the  
6 investment advisory customers money to the extent that it  
7 was invested in T-bills.

8 A I'm not sure I understand your question.

9 Q Isn't it a fact, Mr. Dubinsky, that the T-bill  
10 investments that Mr. Madoff made with investment advisory  
11 customers money earned interest?

12 A Are you talking about the overnight sweeps?

13 Q No, I'm not. I'm talking about the eight or nine firms  
14 that you've acknowledged that Madoff purchased T-bills  
15 through with investment advisory customers money.

16 A So --

17 Q And those T-bills paid interest, right?

18 A Those T-bills paid interest. I don't know when you  
19 said whether they made money, I don't know. I didn't  
20 analyze that because, depending on when you buy them at par  
21 or below par and the interest that you collect with accrued  
22 interest. And then when you sell them, you may make money,  
23 you may not. I did acknowledge, and I said during my  
24 direct, money was used from the 703 for the overnight sweep.  
25 I said that earned interest. That was a way to kind of keep

1 MS. CHAITMAN: Okay.

2 THE COURT: Okay.

3 Q Isn't it a fact that if a customer was credited with a  
4 T-bill which appreciated during the period of the customer's  
5 ownership, that the customer is entitled to that  
6 appreciation?

7 A I disagree with you.

8 Q Now, is it your testimony that the market making part  
9 of Madoff's business was a Ponzi scheme?

10 A No, I did not issue that opinion.

11 Q Okay. And is it your testimony that the proprietary  
12 trading part of the business was a Ponzi scheme?

13 A No, I did not issue that opinion.

14 Q Okay. So out of the whole operation of 180 or so  
15 employees, it's 8 to 10 employees who, in your opinion, were  
16 involved in a Ponzi scheme; is that right?

17 A That's correct.

18 Q Okay. Now, are you aware that the Nelsons never sent a  
19 check payable to Bernard L. Madoff Investment Securities,  
20 LLC?

21 A I don't know one way or the other.

22 Q Okay. And are you aware that every check that the  
23 Nelsons received was from an account in the name of Bernard  
24 L. Madoff, that they never received a check from the LLC?

25 MR. HUNT: Objection, Your Honor. That

1 earlier just said Bernard L. Madoff. Now this one says  
2 Bernard L. Madoff Investment Securities.

3 Q Okay.

4 MS. CHAITMAN: Can you go to the next year?

5 Q Okay. This is December 2005. It doesn't say LLC on  
6 the account, does it?

7 A I agree with you it does not.

8 Q Okay.

9 MS. CHAITMAN: Can you go to 2006?

10 Q Doesn't say LLC on December 2006, does it?

11 A It does not.

12 Q Okay.

13 MS. CHAITMAN: Can you go to 2007?

14 Q It doesn't say LLC on 2007, does it, December 2007?

15 A I would agree with you, yes, does not.

16 Q Okay.

17 MS. CHAITMAN: Can you go to any statements we  
18 have in 2008?

19 Q Okay. This is December -- November 29th to December  
20 31, 2008. Do you see it says Bernard L. Madoff Investment  
21 Securities?

22 A I see that.

23 Q Okay. So in the entire period applicable to the case  
24 against the Nelsons, J.P. Morgan Chase never issued a  
25 statement in the name of the LLC; isn't that true?

1 A Well, you showed me a statement that first started as  
2 Bernard L. Madoff when it was a sole proprietor. Then we  
3 both agreed that it became an LLC in January of 2001.  
4 There's then a name change on the J.P. Morgan Chase  
5 statements that then says Bernard L. Madoff Investment  
6 Securities; that certainly wouldn't be an individual. But I  
7 agree with you it does not say the letters LLC on any of  
8 these.

9 Q You're aware, are you not, that Mr. Madoff used the  
10 trade name Bernard L. Madoff Investment Securities prior to  
11 his formation of the LLC?

12 A Yes. I saw it on many documents, yes.

13 Q Okay. And, in fact, we just pulled up something, DX-X,  
14 which is dated December 19th, 1996. And do you see that  
15 even as far back as December 1996, he was using Bernard L.  
16 Madoff Investment Securities?

17 A I see that, yes.

18 Q So that was really just a trade name that he used,  
19 right?

20 MR. HUNT: Objection, Your Honor. This witness is  
21 not qualified to talk about trade names, corporate  
22 structure.

23 Q You know the difference between a trade name and an  
24 LLC, don't you?

25 THE COURT: Well, there's an objection. Do you



1 MR. HUNT: Your Honor, I would concur that she's  
2 asking about the report that has been issued that's not part  
3 of this case.

4 THE COURT: We can deal with it on redirect.

5 Q Isn't it a fact that you now know that most convertible  
6 bond trading was done on -- was done in New York by the  
7 counter market?

8 A I knew at the time as well when I issued this report;  
9 there's a footnote in the report that explains that. And  
10 there was additional analysis done post-facto because either  
11 you or somebody had raised the criticism of that.

12 Q Right. Now, did you look to see what accounts Madoff  
13 had safekeeping arrangements with, what banks he had  
14 safekeeping arrangements with?

15 THE COURT: What do you mean by that?

16 Q Well, you testified that in trying to analyze Madoff's  
17 stock and T-bill position, you went only to the DTC records.

18 A Correct.

19 Q But isn't a fact that Mr. Madoff also kept securities  
20 with financial institutions from which he bought them?

21 A As in the eight brokerage accounts, yes.

22 Q Yes. And you didn't -- you didn't calculate the  
23 securities that he had in those brokerage accounts; isn't  
24 that true?

25 A The securities in those brokerage accounts were for the

C E R T I F I C A T I O N

I, Sonya Ledanski Hyde, certified that the foregoing  
transcript is a true and accurate record of the proceedings.

Sonya Ledanski Hyde

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Date: May 10, 2019